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THE ANTI-KICKBACK ENFORCEMENT ACT OF 1986

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Mr. ROTH, from the Committee on Governmental Affairs, submitted the following

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REPORT

[To accompany S. 2250]

The Committee on Governmental Affairs, to which was referred the bill (S. 2250), to strengthen the prohibition of kickbacks relating to subcontracts under Federal Government contracts, having considered the same, reports favorably thereon with an amendment and recommends that the bill as amended do pass.

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The Committee on Governmental Affairs, to which was referred the bill (S. 2250) to strengthen the prohibition of kickbacks relating to subcontracts under Federal Government contracts, having considered the same, reports favorably thereon with an amemdment in the nature of a substitute and recommends that the bill as amended do pass.

I. Purpose

The purpose of S. 2250, the Anti-Kickback Enforcement Act of 1986, is to close loopholes in and broaden the coverage of the Anti-Kickback Act, 41 U.S.C. 51–54, in order to deter kickbacks relating tc subcontracts under Federal Government contracts.

II. Background

A. SUBCONTRACTOR KICKBACKS

Subcontractor kickbacks, as used in this report, refer to a form of commercial bribery affecting business transactions among the United States, its prime contractors and subcontractors. In a typical case, the United States awards a prime contract to a particular company which decides to subcontract part or all of the work to others. One or more of the potential subcontractors, to obtain favorable treatment in the subcontracting process, offers or provides kickbacks to key personnel of the prime contractor. In return, usually without informing or involving their employers, the prime contractor employees help the paying subcontractors obtain awards or other preferential treatment in the procurement process.

Kickbacks are provided in the form of cash, free use of a credit card, paid vacations, gifts, or other items of value. The amount of the kickback is often tied to the dollar value of the subcontract involved, ranging from 2 to 15% of the subcontract price. Subcontractors usually inflate the subcontract price to include the cost of the kickbacks they pay, and these inflated prices are, in most cases, passed on to the United States.

The prime contractor employees most often involved with kickbacks are those having direct contact with subcontractors and some influence over the award process. They are usually buyers, subcontract administrators or procurement supervisors, but can also be engineers, quality assurance personnel or senior officials. They employ a variety of tactics to assist favored subcontractors, including providing information about competitors, fabricating bids, disqualifying low bidders, and disclosing a proposal's target costs and product features.

Subcontractor kickbacks have been condemned for distorting and weakening the federal procurement system. The Committee believes that kickbacks destroy true compeitition for Government subcontractors, cause honest subcontractors to lose work, and inflate the product prices charged to the American taxpayer. Some experts suspect that subcontractors who obtain business through kickbacks supply inferior goods or services to the federal Government. Still other observers charge that kickbacks foster corruption throughout the federal procurement system by creating an environment in which unethical conduct is tolerated.

The budgetary impact of subcontractor kickback schemes is unclear due to the secrecy surrounding the practice. In 1985 in the defense industry alone, the United States spent approximately $147 billion on procurement, approximately $46 billion of which was awarded to subcontractors by prime contractors. When other federal procurement costs are also considered, the price inflation attributable to kickback activities may involve millions of dollars each year.

B. THE ANTI-KICKBACK ACT

The United States first outlawed subcontractor kickbacks on March 8, 1946, when Congress passed the Anti-Kickback Act, 60 Stat. 37. This legislation, codified at 41 U.S.C. 51-54, prohibits the "payment of any fee, commission or compensation of any kind" or the "granting of any gift or gratuity" to induce or acknowledge the award of a Government subcontract. It imposes criminal sanctions on anyone who makes or receives subcontractor kickbacks in violation of the Act, and it enables the United States to recover the amount of such kickbacks through civil suits or administrative setoffs. The statute also states that "[u]pon a showing that a subcontractor paid [a kickback] . . . it shall be conclusively presumed that the cost of such expense was included in the price of the subcontract . . . and ultimately borne by the United States."

This statute is the only law in the United States Code which deals explicitly and solely with subcontractor kickbacks affecting federal procurement. It was enacted after World War II in response to defense contract audits by the General Accounting Office (GAO) which found that firms were paying "commissions" to defense prime contractor employees to obtain subcontracts. The Comptroller General issued a special report to the Congress on October 5, 1943, recommending corrective legislation. The statute later enacted closely resembled GAO's proposal.

The Act originally applied only to "cost-plus-fixed-fee or other cost reimburseable contracts." These are contracts which require the Government to reimburse a prime contractor for all subcontract costs. GAO had identified these contracts as ones through which prime contractors passed on kickback costs incurred by their subcontractors. Later, after a federal court dismissed a kickback indictment involving a price determinable contract, GAO recognized that kickback costs could be included in other types of contracts as well and recommended expanding the Act to apply to all negotiated contracts. (See letter dated March 22, 1960, from Comptroller General to the Speaker of the House of Representatives, 1960 U.S. Code Cong. & Adm. News 3293.) Congress enacted this suggestion into law on September 2, 1960. (See P.L. No. 86-695, 74 Stat. 740.) This amendment is the only change in the Act since 1946.

C. SENATE OVERSIGHT SUBCOMMITTEE INVESTIGATION

In late 1985, the Senate Subcommittee on Oversight of Government Management initiated an investigation into the issue of subcontractor kickbacks in the defense industry and the adequacy of the existing Anti-Kickback Act to handle the problem. The Subcommittee interviewed industry, law enforcement and government

officials throughout the country and, on February 27, and June 11, 1986, held hearings on this matter.

1. The extent of the problem

The investigation conducted by the Subcommittee in 1985 and 1986 established that subcontractor kickbacks are a widespread, well-entrenched problem in the defense industry.

Staff investigators spoke with more than two dozen law enforcement officals, a dozen representatives of the Department of Justice, Department of Defense, and Internal Revenue Service (IRS), several individuals who had actually paid or received kickbacks, and more than two dozen companies which perform defense prime contracts or subcontracts. Inquiries were made about the number and type of kickback schemes uncovered to date as well as the extent of law enforcement, government and industry efforts to combat this type of subcontractor fraud.

The Subcommittee was told in interviews that the defense industry was "riddled" with subcontractor kickback schemes. It received estimates that 10 to 50% of the front-line procurement personnel at prime contractors solicited or accepted kickbacks. This information was repeated publicly at the Subcommittee hearing held on February 27, 1986, when Robert C. Bonner, U.S. Attorney for the Central District of California and a leader in kickback prosecutions, testified that:

> Kickbacks on defense subcontracts are a pervasive, long-standing practice which has corrupted the subcontracting process at most, if not all, defense contractors, and infected most, if not all, defense procurement programs within the Central District of California. . . . The practice . . . is so pervasive and entrenched, and it is of such dominating proportions, that it is sad to say that many suppliers believe they cannot survive economically unless they pay kickbacks to buyers or prime contractors.

U.S. Attorney Bonner estimated that, in southern California, "up to 50 per cent of the buyers or front-line procurement personnel at prime contractors take kickbacks in return for issuing subcontracts."

John Volz, U.S. Attorney for the Eastern District of Louisiana, testified at the hearing about a similarly pervasive problem at a shipyard near New Orleans. The shipyard is run by Avondale Shipyards, Inc., a defense prime contractor. Longstanding kickback schemes involving Avondale employees have resulted in 26 convictions to date. U.S. Attorney Volz testified that:

> [K]ickbacks were a way of life. . . . [C]ertain Avondale employees received thousands of dollars in kickbacks, and . . . the taxpayers were bilked for more than $1 million. . . . [The vendors involved in the kickback schemes also] were dealing with other defense contractors, so you would assume that if they are carrying on this kind of activity at Avondale, they are carrying it on elsewhere.

Jeffrey Jamar, Chief of the Federal Bureau of Investigation (FBI) White Collar Crime Section, testified at the hearing that, in addi-

tion to California and Louisiana, the FBI had identified "significant" kickback problems in New England, the Midwest and other areas. He described a variety of kickback schemes the FBI had uncovered and confirmed that the FBI had increased its prosecution of this type of defense fraud. He testified that the FBI, together with U.S. Attorneys, the Department of Defense and the IRS, had begun to form task forces to uncover and prosecute ongoing schemes. He also described FBI participation in industry efforts to stop employee corruption.

The Department of Defense further confirmed the gravity of the problem in the defense industry. In a letter prepared for the hearing record, Joseph H. Sherick, Inspector General for the Department of Defense, stated that subcontractor kickbacks were a "serious problem" which had become one of his office's "top investigative priorities." He reported "a significant increase during the past year in the number of investigations involving illegal kickbacks." (See letter dated February 24, 1986, included in the February hearing record.) In a separate letter responding to Subcommittee inquiries, the Defense Contract Audit Agency listed 22 kickback investigations it had been involved with over the past ten years in such states as California, Delaware, Florida, Maryland, Massachusetts, Missouri, New York, Virginia and Wisconsin. It indicated that several of these investigations had involved millions of dollars in kickback payments.

The IRS is another participant in subcontractor kickback investigations. Responding to Subcommittee inquiries, the IRS reported kickback investigations involving both defense and nondefense contracts in at least 17 states throughout the country since 1981. Its investigations focus not only on taxpayers who fail to report kickback payments as taxable income, but also on taxpayers who attempt to claim kickback costs as deductible business expenses, since such deductions are illegal under Section 162(c) of the Internal Revenue Code. The IRS reported finding illegal kickback deductions in the form of charges to expense accounts, false invoices, charges to job costs, payroll deductions to nonworking persons, commission expenses, credit card charges, rent expenses, lease expense and loans. Charges of tax evasion have played a prominent role in many federal kickback prosecutions to date.

Further documenting the extent of the kickback problem, the Subcommittee compiled a list of recent kickback prosecutions and investigations affecting defense contracts. (See summary included in the February hearing record.) Federal indictments for kickback schemes have been filed in California, Massachusetts, Missouri, New Jersey, New York, South Carolina and Texas. Major defense prime contractors were among the companies with employees indicted for kickbacks, including E.I. Dupont Company, General Dynamics Corporation, Hughes Aircraft Company, Lockheed Missiles & Space Company, Northrop Corporation, Raytheon Corporation, Singer Company, and Teledyne, Inc. Millions of dollars and major weapons procurements were involved in these cases.

More recent indictments, filed during the summer of 1986, include a series in California charging 19 individuals and one supplier with kickbacks affecting numerous defense contracts. The affected programs include the space shuttle, B-1 bomber, the F-15, F-16

and F-18 fighter airplanes, the cruise missile, the Army's Black Hawk helicopter, radar systems, communications satellites, and various classified weapons programs. Also, in Massachusetts, the officers of one of the largest privately owned machine shops in New England were indicted for compiling a "slush fund" of more than $750,000 to pay kickbacks to employees of General Electric Company for defense subcontracts. At least ten employees had already resigned from or been fired by General Electric for suspected participation in kickback schemes.

While documenting the pervasive nature of subcontractor kickbacks in the defense industry, the Subcommittee was presented with a related issue on industry personnel practices. A three-month investigation, culminating in the hearing on June 11, 1986, revealed that defense prime contractors routinely fail to exchange accurate information about prospective employees, thereby enabling persons suspected of kickback activities to obtain reemployment in the defense procurement field.

The issue of personnel practices was first raised at the February hearing when witnesses testified that prime contractors were reluctant to tell other companies about employees suspected of unethical conduct, because they were afraid that the employees in question would sue them for defamation or invasion of privacy. (See testimony of Jeffrey Jamar of the FBI and Tom B. Carvey of the Hughes Aircraft Company.)

In examining this issue, the Subcommittee staff traced the employment histories of 25 prime contractor employees convicted or suspected of engaging in subcontractor kickbacks, performing a detailed analysis of two selected buyers. The investigation confirmed the existence of a "revolving door" for corrupt employees in which a person leaving one defense prime contractor under suspicion of kickbacks was able to find a new procurement position with another defense firm. The investigation also confirmed that poor industry personnel practices, namely the failure by defense prime contractors to exchange accurate and relevant employment information, facilitated the movement of these employees from one company to the next.

Of the 25 employees investigated by the Subcommittee, more than one-third had left their jobs under suspicion of taking kickbacks yet found new positions with other defense firms. Of this one-third, more than half were caught or strongly suspected of taking kickbacks during their subsequent employment. Two of these individuals were caught taking kickbacks by three employers. One individual, convicted in 1983 for taking kickbacks, had been able in 1984 to find a new job as a buyer with a major defense contractor only to be caught yet another time soliciting kickbacks from a subcontractor.

In the two cases examined in detail, one employee had found a new procurement position with a major defense firm while suspected from his old job pending kickback investigations by a grand jury, the FBI and his employer. The other employee had found a new procurement position while he was under FBI and company investigations and after his former employer procured a tape recording and sworn statement documenting his kickback activities with multiple subcontractors.

The investigation further documented prime contractors' generally poor personnel records. Review of personnel files demonstrated that key information was frequently inaccurate or missing, such as the reason the employee left the company, whether the employee was eligible for re-hire, and whether the employee was suspected of unethical conduct. The personnel files rarely referred to crucial information in other company files documenting an employee's suspect behavior. The personnel files also demonstrated companies' failure to obtain or verify important information about job applicants for procurement positions.

Representatives from three major defense prime contractors, Northrop Corporation, TRW, Inc., and Garrett Corporation, disagreed that their records were poorly maintained but admitted that their companies generally did not exchange information with prospective employers about current or past employees. They testified that their companies' policies were attributable to their fear of being sued by employees for defamation or invasion of privacy.

In response, an expert in employment law testified that the companies' fear of litigation was ill-founded. Theodore J. St. Antoine, Degan Professor of Law and former Dean of the University of Michigan Law School and Co-Chair of the American Bar Association Committee on the Law of Individual Rights and Responsibilities in the Workplace, testified that case law currently extends a qualified privilege to information exchanged about job applicants. He stated that:

> [M]any employers today are much too timid and reticent when faced with legitimate inquiries about former or current employees. The estimated case law simply does not justify the position that they should confine their responses to the practical equivalent of "name, rank, and serial number." . . . Too many employers, I believe, may simply be taking the easy way out in failing to pass on information that any responsible person would regard as relevant. . . . I consider it an outright shirking of an employer's obligation, civic if not legal, to the business community and the larger society.

Responding to detailed inquiries about the legal consequences of an employer's providing information about an employee to a prospective employer, Professor St. Antoine indicated that such information could be exchanged without incurring an unreasonable risk of civil liability for defamation. He explained that "statements made in good faith and without malice do not incur legal liability, even if they turn out in fact to be inaccurate and injurious." due to the qualified legal privileges extended to such exchanges of employment information. (See testimony and letters dated July 7 and August 4, 1986, included in the June hearing record.)

The June hearing convinced the Subcommittee that poor industry personnel practices contribute to the problem of subcontractor kickbacks and should be improved to help keep corrupt individuals out of sensitive procurement positions.

2. The need for legislation

In addition to documenting the gravity of the subcontractor kickback problem in the defense industry, the Subcommittee investigated the adequacy of the existing Anti-Kickback Act to deal with this type of procurement fraud. The investigation established that the Anti-Kickback Act contains numerous, serious defects which severely limit its usefulness as a kickback deterrent.

In 1985 and 1986, the Subcommittee staff conducted detailed interviews with representatives from the Department of Justice, FBI, several U.S. Attorney Offices, Department of Defense, Defense Procurement Fraud Unit, and GAO, on their experiences with federal kickback prosecutions. These interviews indicated that most kickback convictions were being obtained with statutes other than the Anti-Kickback Act; federal wire and mail fraud statutes or criminal provisions in the tax code were identified as the most commonly used statutes. The interviews further indicated that law enforcement officials would prefer to use a statute focused on the particular problem of subcontractor kickbacks, if that statute were well designed. Finally, the interviewees described the major defects in the existing Anti-Kickback Act. Many of the Act's problems were discussed at the February hearing by Victoria Toensing, Deputy Assistant Attorney General of the Department of Justice.

Among the most prominent defects in the Anti-Kickback Act identified during the Subcommittee investigation and hearings are the following:

a. The Act applies only to "negotiated contracts."

In 1960, the GAO recommended and Congress adopted a provision which made the Anti-Kickback Act applicable not only to cost-reimbursable contracts but also to all "negotiated contracts." This new term expanded the scope of the Act but, over time, has proved to be overly restrictive and troublesome. The Department of Justice testified at the February hearing that subcontractor kickbacks on non-negotiated contracts, such as sealed bid contracts, are a "serious problem." The Subcommittee staff also found no basis for believing that non-negotiated contracts are free from kickbacks, since subcontracter bids on any federal contract can be inflated with hidden kickback costs. Law enforcement officials indicate that the term can be interpreted in a technical fashion, thereby complicating trials, confusing jurors, and providing wrongdoers with a possible loophole in the law. The consensus among those contracted by the Subcommittee was that the Act should apply to all federal contracts.

b. The Act applies only to executed kickbacks.

Several persons observed that the existing Act does not apply to attempted kickbacks, such as offers or solicitations of kickbacks which are refused. All recommended amending the Act to prohibit such misconduct.

c. The Act applies only to kickbacks paid to induce or acknowledge the award of a subcontract.

Many persons observed that the Act prohibits only those kickbacks made for purpose of inducing or acknowledging the award of a subcontract. Thus, the Department of Justice testified in February that the Act does not prohibit kickbacks paid for other purposes, such as "to obtain information about competing subcontractors' prices, specifications, suppliers, and delivery schedules . . . to obtain acceptance of items that have not been tested as required, or items that do not meet specifications or are otherwise defective . . . to obtain modifications of negotiated contracts previously awarded or to change orders to existing contracts." The Department of Justice advocated prohibiting kickbacks made for any of these purposes. In its February 24 letter, the Deparment of Defense recommended prohibiting kickbacks made "with the intent of influencing any action in connection with a Government contract, whether it be during the award phase or during the performance." All agreed that the Act's current limitation severely restricted its usefulness.

d. The Act has relatively light criminal penalties.

The Department of Justice testified that the Act's current provisions for a maximum two-year prison term and $10,000 fine are "out of line with other federal fraud and corruption statutes which typically provide for imprisonment for five years or more." Law enforcement officials explained that these relatively light penalties rendered the statute unattractive for prosecutions, because they signaled to a judge that the misconduct at issue was not serious and also restricted prosecutors' ability to draft plea agreements with significant prison terms. The Department of Justice thus advocated amending the Act to increase its criminal penalties.

e. The Act has limited civil recovery provisions.

The Department of Justice and others noted that, civilly, the Act provides for the recovery of only those kickback amounts passed on to the Government. They noted that such provisions did not compensate the Government for its expenses in investigating and prosecuting the misconduct, nor did they provide a civil deterrent to wrongdoers. Stronger provisions were urged, with the Department of Justice advocating civil recovery of "double the amount of damages it sustained, or double the amount of the kickback, whichever it greater"; and the Department of Defense recommending civil recovery of "at least three, but not more than ten times" the value or any kickback payment.

f. The Act contains confusing language.

An additional reason given for not using the Anti-Kickback Act is its confusing text. Critics cite its long, complex sentences, antiquated terminology, and lack of definitions. All recommended modernizing and clarifying the Act's provisions.

The high degree of consensus in the law enforcement community about the serious defects in the Anti-Kickback Act and the benefits

of improving the Act convinced the Subcommittee that the statute should be subject to a thorough legislative overhaul.

III. Provisions of S. 2250

S. 2250 strengthens the existing Anti-Kickback Act, 41 U.S.C. 51-54, by clarifying its provisions and broadening its coverage. Among other measures, it stiffens the Act's criminal penalties, authorizes civil recovery of double damages and forfeitures, makes the Act applicable to all types of contracts and to attempted as well as completed kickbacks, and prohibits kickbacks to obtain any type of favorable treatment in connection with a federal contract.

The bill was introduced on March 27, 1986, with the unanimous cosponsorship of the members of the Oversight Subcommittee. After soliciting comments from the Department of Justice, Department of Defense, General Accounting Office, General Services Administration, the American Bar Association and industry, the Subcommittee re-drafted the bill with an amendment in the nature of a substitute. On July 21, 1986, the Subcommittee unanimously reported the bills, as amended, to the full Committee. On August 12, 1986, the Committee ordered the amended bill to be reported to the Senate.

A detailed discussion of the substantive provisions of S. 2250 follows, with emphasis on the changes that S. 2250 would make in existing law.

SECTION 1: TITLE

Section 1 of the bill identifies the statute, if enacted into law, as the "Anti-Kickback Act of 1986."

SECTION 2: DEFINITIONS

The existing Anti-Kickback Act defines only three terms. "subcontractor," "person" and "negotiated contract." 41 U.S.C. 52. Section 2 of the bill modifies these definitions and adds several new ones.

Section 2(1) defines "contracting agency," a term which does not apear in the existing Act. The definition parallels language in the Act which refers to contracts "entered into by any department, agency, or establishment of the United States." 41 U.S.C. 51.

Section 2(2) defines "kickback," a term which does not appear in the text of the existing Act but is a key element in the legislation. The term is used to clarify and broaden the discription of conduct prohibited by the Act.

First, the definition clarifies the prohibition against transactions to obtain preferential treatment in the federal procurement process. The existing Act prohibits the "payment of any fee, commission, or compensation of any kind or the granting of any gift or gratuity of any kind." 41 U.S.C. 51. Section 2(2) defines "kickback" to mean any money, fee, commission, credit, gift, gratuity, thing of value, or compensation of any kind," The definition thus encompasses the existing Act's language, while adding the generic terms. "Money," "credit," and "thing of value." With this broader language, the bill clearly prohibits, for example, a subcontractor from

arranging a low-interest loan or the free use of a credit card in exhange for the award of a subcontract.

Some industry representatives suggested that the definition of kickback be restricted to items worth more than a specified dollar amount. They were concerned that, otherwise, the legislation would be interpreted to outlaw the exchange of *de minimus* gifts normal in business settings, such as meals or commemorative tokens.

The Committee does not intend S. 2250 to prohibit such *de minimus* business gifts. In order to exempt them from the bill, the Committee amended the definition of kickback to cover only those transactions made for the purpose of influencing procurement decisions. This change generally excludes inexpensive items from the Act's coverage, since the exchange of *de minimus* gifts could not reasonably be expected to influence procurement decisions. At the same time, the definition does not exempt all low-dollar transactions from the Act's coverage, due to unforseen fact patterns. For example, a subcontractor who provided a buyer with a $20 lunch on a single occasion would not normally be considered as having provided a kickback; however, a subcontractor who arranged weekly $20 lunches for multiple buyers might be. The Committee thus adopts the approach taken in the existing Act; it does not specify a minimal dollar figure for a kickback, but relies instead on federal prosecutors to apply the law in a reasonable manner, to cases where compensation is provided as a *quid pro quo* for favorable treatment or as part of a design to induce improper favoritism in the subcontracting process.

Second, the definition prohibits payments to a "prime contractor, prime contractor employee, subcontractor or subcontractor employee." This language is intended to parallel language in the existing Act and these terms are explained later in this report.

Third, the definition prohibits payments "for the purpose of obtaining or acknowledging favorable treatment" in connection with a prime contract or related subcontract. This language broadens the reach of the existing Act which prohibits only those payments made "as an inducement for the award of a subcontract or order . . . or as an acknowledgment of a subcontract or order previously awarded." 41 U.S.C. 51. The new language prohibits payments made to obtain or acknowledge any type of favorable treatment in the procurement process.

Examples of "favorable treatment" covered by S. 2250 include, but are not limited to, receiving improper advance notice of a request for bids on a subcontract; obtaining certification as an eligible bidder without meeting the proper standards or when the bidders list has been improperly restricted; obtaining normally unavailable information about a competitor's bid or a project that is the subject of the subcontract; receiving unusual assistance in writing a bid; being allowed to submit a bid after a deadline has passed; reaceiving improper sole source consideration; improperly obtaining an award; obtaining unwarranted contract modifications; obtaining acceptance of substandard goods; being permitted to charge inflated prices or to recover improper expenses; and, in the case of independent sales representatives, receiving improper referrals of persons interested in bidding on subcontracts. "Favorable treat-

ment" is intended to be construed broadly to reach the many types of improper behavior which may be the object of a commerical bribe.

Finally, the definition prohibits payments made "in connection with a prime contract or in connection with a subcontract relating to a prime contract." This language is intended to prohibit kickbacks in any of the complex and varying contractual arrangements and relationships associated with performing a prime contract. The definition is thus intended to encompass, *inter alia*, kickbacks paid by higher or lower tier subcontractors; by companies which furnish gneral supplies to a prime contractor or related subcontractor, when those companies knew or should have known that their supplies would be used on government-related work; and by independent sales representatives to obtain favorable treatment for themselves or the companies they represent.

Section 2(3) defines "person" in a manner similar to the existing definition in the Act. The term is intended to be construed broadly to cover any individual or business entity.

Section 2(4) defines "prime contract," a term which does not appear in the existing Act. This term, in essence, replaces "negotiated contract" as a key element of the statute. The change reflects a decision by the Committee, based on recommendations by the Department of Justice and others, to expand coverage of the Act to prohibit kickbacks in connection with any type of federal contract, not just negotiated contracts.

The term is intended to be construed broadly. It incorporates the Act's general language on contracts for "supplies, materials, equipment or services of any kind," 41 U.S.C. 51, and refers to both "contracts and contractual actions," to insure its application to, *inter alia*, written and oral contracts, purchase orders, telephone orders, letter agreements, change orders and other contractual arrangements, of any dollar amount.

Section 2(5) defines "prime contractor," a term which is not defined in the existing Act. The definition, when read with the definition of "prime contract," parallels language in 41 U.S.C. 51, but covers persons holding any type of prime contract rather than only those holding negotiated contracts. The term is intended to be construed broadly.

Section 2(6) defines "prime contractor employee," a term which is not defined in the existing Act. The definition parallels language in 41 U.S.C. 51 which prohibits payments to any prime contractor or to "any officer, partner, employee, or agent of a prime contractor." The term is intended to be construed broadly and may include, *inter alia*, a prime contractor's owners, directors, trustees or independent sales representatives if any of these persons were acting to benefit or on behalf of the prime contractor when participating in a kickback scheme.

Section 2(7) defines "subcontract," a term which is not defined in the existing Act. The term is intended to be construed broadly, reaching written and oral subcontracts, purchase orders, telephone orders, letter agreements, change orders and other contractual arrangements, of any dollar amount. The term applies to contractual arrangements between a prime contractor and subcontractor and

to contractual arrangements between higher and lower tier subcontractors who are performing tasks related to a prime contract.

Section 2(8) defines "subcontractor," a term which is also defined in the existing Act. The new definition is broader in two respects. It covers persons acting under any type of prime contract rather than only those acting under a negotiated contract. It also applies not only to persons who "hold" an agreement or purchase order under a prime contract, but also to persons who "offer" to perform under a prime contract. This language makes it clear that S. 2250 applies to all persons who bid on a subcontract and engage in kickbacks to obtain favorable treatment in the bidding process, whether or not the bidder wins the award. The definition further clarifies the Act's applicability to companies who furnish general supplies to prime contractors or related subcontractors.

Finally, Section 2(9) defines "subcontractor employee," a term not defined in the existing Act. The definition parallels language in 41 U.S.C. 51 prohibiting kickbacks to "any officer, partner, employee, or agent of a higher tier subcontractor holding a subcontract under the prime contract." The term is intended to be construed broadly and may include, *inter alia,* a subcontractor's owners, directors, trustees or independent sales representative if any of these persons were acting to benefit or on behalf of the subcontractor when participating in a kickback scheme.

SECTION 3: PROHIBITED CONDUCT

The existing Anti-Kickback Act and S. 2250, as introduced, contain long, complex descriptions of the conduct they prohibit. S. 2250 was amended to simplify the key passages. By refining the definition of "kickback," S. 2250 was able, in Section 3, to present a clear and concise description of the prohibited conduct.

In addition to simplifying the descriptive language, the bill broadens the Act in two ways. First, Section 3(a) prohibits, for the first time, attempted as well as completed misconduct. Second, through the definition of "kickback," Section 3(a) prohibits payments to obtain or acknowledge any type of favorable treatment in connection with any type of prime contract. To the extent that Section 3(a) prohibits the payment or acceptance of a kickback and the inclusion of the cost of a kickback in a contract price, it parallels the existing Act.

Section 3(b) sets forth a conclusive presumption similar to the conclusive presumption now in the Anti-Kickback Act, 41 U.S.C. 51, and it is intended to have the same effect. Language changes have been made solely to clarify when the presumption applies and to reflect the broader reach of the legislation. For example, the bill clarifies that the conclusive presumption applies only to proceedings in "a civil suit or administrative action commenced under this Act." That provision codifies current case law. *See, e.g., Travers v. United States,* 361 F.2d 753, 755 (1st Cir.), *cert. denied,* 385 U.S. 834 (1966) (presumption does not apply to criminal proceedings). The bill also makes it clear that the conclusive presumption applies only when the United States has made a showing that a kickback has actually been paid or accepted. Thus, the conclusive presump-

tion does not apply to cases which involve only attempted misconduct.

SECTION 4: CRIMINAL PENALTIES

The existing Act subjects violators to a maximum prison term of 2 years and a maximum criminal fine of $10,000. 41 U.S.C. 54. Based upon testimony by the Department of Justice that these penalties are insufficient, Section 4 of the legislation increases the maximum prison term to 10 years and the maximum criminal fine to $250,000 for individuals and $1 million for persons other than individuals. These penalties are comparable to those in other federal criminal fraud and corruption statutes.

Section 4 further strengthens the Act's criminal provisions by making them applicable to any person who knowingly engages in prohibited conduct. The existing Act applies only to persons who knowingly "make or receive" kickbacks. Thus, S. 2250 sanctions attempted as well as executed misconduct and the knowing inclusion of kickback costs in contract prices as well as the knowing payment or receipt of subcontractor kickbacks.

SECTION 5: CIVIL ACTIONS

The existing Act permits the United States to recover the "amount of any [kickback] from the subcontractor or the recipient thereof by . . . an action in an appropriate court of the United States." 41 U.S.C. 51. Based upon testimony by the Department of Justice and others that this civil recovery measure is inadequate, Section 5 of the legislation expands the Act in two ways.

First, Section 5(a) permits the United States to institute a civil suit against "any person" who violates the Act. The existing statute limits recovery to suits against "the subcontractor or the recipient" of a kickback and thereby exempts from civil liability the prime contractor who charges the kickback costs to the United States, even where the prime contractor has acted knowingly. The bill takes a more even-handed approach, permitting civil recovery against anyone who violates the Act.

Industry representatives have argued that prime contractors should not be held civilly liable for including kickback costs in prime contract prices because, in many cases, they do not know they are doing it. They explain that prime contractor employees or subcontractors who participate in kickback schemes usually hide their illegal activities from the prime contractor as well as from the Government. The prime contractor is, in this way, kept ignorant of inflated charges in subcontractors' bids and unknowingly pass on the charges to the United States. Industry representatives argue that prime contractors are defrauded in the same way as the Government, to the extent they pay these inflated charges.

While the Committee recognizes that prime contractors are also frequent victims of subcontractor kickback fraud, it does not agree that prime contractors should therefore be excused from any civil liability under the Act. Several factors indicate the opposite.

First, prime contractor employees are commonly key participants in the kickback schemes. To date, they make up the majority of persons in the defense industry who have been convicted of kick-

back charges. The longstanding doctrine of *respondeat superior* holds employers responsible for the actions of their employees. This responsibility exists usually whether or not an employer knew of an employee's actions at the time they were performed and whether or not the employer had forbidden the misconduct at issue. See 57 C.J.S. 555 *et seq.*; 53 Am. Jur. 2d 417 *et seq.*; *Domar Ocean Transportation, Ltd.* v. *Independent Refining Co.*, 783 F.2d 1185 (5th Cir. 1986).

One of the principles underlying the doctrine of *respondeat superior*, that employers should supervise their employees to prevent improper or dangerous conduct, is clearly applicable to the subcontractor kickback problem. U.S. Attorney Bonner warned the Oversight Subcommittee in its first hearing that kickbacks could not be stopped without self-policing efforts by defense employers:

> Criminal prosecution alone cannot solve the problem of kickbacks. . . . [E]veryone involved in the defense procurement process must be willing to acknowledge that kickbacks are a serious problem in the defense industry and commit themselves to a sustained effort to remedy the problem.

Prime contractors are better situated than the Government to detect and prevent kickback schemes perpetrated by their employees and subcontractors. They need incentives, however, to exercise their oversight capabilities. Civil liability for kickback costs is one such incentive. *Cf. American Society of Mechanical Engineers, Inc.* v. *Hydrolevel Corp.*, 456 U.S. 556, 572 (1982) (principal held civilly liable under antitrust law for agent's anticompetitive actions to encourage supervision of agents to deter such misconduct).

Further, the bill bases the prime contractor's liability upon its own wrongful action—charging the United States for the cost of illegal kickbacks. While it may be true that the prime contractor acts unknowingly, the fact remains that it passes these costs along to the Government improperly and should repay them.

Still another reason to hold the prime contractor liable for kickback costs it passes on to the Government is that the prime contractor is usually better situated to recover damages from the party most responsible for the wrongdoing. For example, the prime contractor may have direct contractual relationships with the wrongdoer which will enable the prime contractor to exercise offset privileges or arrange settlements not available to the United States. Prime contractors may even have contract provisions which will enable them to recover kickback costs in the event of a suit by the Government.

For these reasons, the Committee believes prime contractors should be held civilly liable for kickback costs they include in contract prices charged to the United States. S. 2250 expands the Act's civil provisions accordingly.

S. 2250 also expands the Act's civil recovery provisions by authorizing double damages and forfeitures in cases of knowing misconduct. Section 5(a)(2) provides that, in cases where a person knowingly engages in prohibited conduct, the United States can recover twice the amount of each kickback involved in the case and up to $10,000 for each occurrence of prohibited conduct. This provi-

sion is intended, not to penalize violators of the Act, but to provide the United States with a civil mechanism to make itself whole after its procurement activities have been tainted by kickbacks.

The United States Supreme Court recognized in a kickback case involving a defense contract that simple recovery of the amount of the kickback in question often fails to compensate the Government for its damages:

> [The defendant] argues . . . that the express provision for recovery of kickbacks is enough to protect the Government from increased costs attributable to them. But this argument rests on two false assumptions. The first is that kickbacks can easily be detected and recovered. This is hardly the case. . . . The second . . . is that the increased cost to the Government is necessarily equal to the amount of the kickback which is recoverable. Of course, a subcontractor who must pay a kickback is likely to include the amount of the kickback in his contract price. But this is not all. A subcontractor who anticipates obtaining a subcontract by virtue of a kickback has little incentive to stint on his cost estimates. . . . [H]e will be tempted to inflate [his] proposal by more than the amount of the kickback. And even if the Government could isolate and recover the inflation attributable to the kickback, it would still be saddled with a subcontractor who . . . is perhaps entirely unreliable in other ways.

United States v. *Acme Process Equipment Co.*, 385 U.S. 138, 144 (1966).

By providing for civil recovery of double damages and forfeitures, the Committee intends to provide a mechanism that will more nearly compensate the Government for all of its damages. For example, these provisions will permit the United States to recover the costs of detecting and investigating the kickbacks; the cost of kickbacks it fails to discover; and for other excess charges and performance problems caused by corrupt subcontractors. *Cf. United States ex rel. Marcus* v. *Hess*, 317 U.S. 537, 550–52 (1943); *Peterson* v. *Richardson*, 370 F. Supp. 1259, 1267 (N.D. Tex. 1973), *aff'd*, 508 F.2d 45 (1975), *cert. denied*, 423 U.S. 830 (1975) (double damages and forfeitures upheld in cases of false claims against the Government as a mechanism for making the Government whole).

S. 2250, as introduced, permitted the recovery of double damages and forfeitures in any situation where a kickback took place. The bill has since been amended to permit double damages and forfeitures only in instances of knowing violations of the Act. This change was made in response to claims by prime contractors that they often unknowingly pass on kickback costs resulting from misconduct between lower tier subcontractors, where no prime contractor employee was involved in the fraud. In such cases, the prime contractors believed it was unfair to hold them accountable for double damages and forfeitures, even where such damages were necessary to compensate the Government. Recognizing that prime contractors can be unwitting participants in lower tier kickback schemes and that the provision for double damages and forfeitures

represents a significant civil liability, the Committee agreed to restrict this type of recovery to cases of knowing violations.

Section 5(b) clarifies the statute of limitations applicable to civil suits under the Act. It specifies a period of 6 years from the date the prohibited conduct occurred or, if the conduct was kept hidden, from the date that the United States should reasonably have become aware that the prohibited conduct had taken place. Six years is a standard time period for filing federal civil actions involving federal contracts, and the tolling language is modeled after that found in 28 U.S.C. 2416(c).

SECTION 6: CODIFICATION OF ACME PROCESS EQUIPMENT CO.

In 1966, the United States Supreme Court held that in addition to criminal and civil suits, the Anti-Kickback Act authorizes the United States to terminate prime contracts which have been tainted by subcontractor kickbacks. *Acme Process Equipment Co.*, 385 U.S. 138, 139.

The case in question involved a prime contract to produce rifles. It was a fixed-price contract with provisions for limited price redeterminations. The Army awarded the contract to Acme Process Equipment Company, the prime contractor. Several Acme employees demanded kickbacks from subcontractors to work on the project. When the United States learned of the kickbacks, it indicted Acme's employees. The District Court acquitted the defendants because the Anti-Kickback Act did not, at the time, apply to price redeterminable contracts. The Court held that the defendants' kickback schemes were "despicable and morally reprehensible, but unfortunately within the narrow letter of the law." *United States* v. *Norris*, Crim. No. 18535 (E.D. Penn. April 14, 1956).

After the Court's ruling, the Department of Defense cancelled the prime contract. The prime contractor, Acme, sued for breach of contract. The Supreme Court dismissed the suit, holding that the Anti-Kickback Act authorized the Government's action:

> The [lower court] held . . . that had Congress wanted to provide the additional remedy of contract annulment, it could have done so by express language . . . and of course it could have. But the fact that it did not see fit to provide for such a remedy by express language does not end the matter. The Anti-Kickback Act . . . clearly expressed a policy decidedly hostile to [kickbacks] . . . This public policy requires the United States be able to rid itself of a prime contract tainted by kickbacks.

385 U.S. at 142–43, 146 (citations and quotation marks omitted).

Section 6 of S. 2250 codifies the holdings of *Acme Process Equipment Co.* It permits the head of a contracting agency, by written notice to the prime contractor, to terminate a prime contract tainted by subcontractor kickbacks. It also permits the prime contractor to challenge this termination, using the procedures set out in the Contract Disputes Act of 1978.

Some industry representatives have argued that the case should not be codified. The Committee decided that, in light of the case's importance and continuing vitality, its authorization of contract

terminations should be recognized in the United States Code and made subject to standard review procedures. The Contract Disputes Act provides for the review of other types of contract terminations by the Government, and its procedures are familiar to the procurement community. This statute is thus an appropriate vehicle for resolving disputes over contract terminations authorized under the Anti-Kickback Act. Judicial review of contract terminations is already included where appropriate.

Section 6, as introduced, included a subsection stating that, in the event a prime contract was terminated under the section, the United States would have the same remedies against the prime contractor that it would have had if the prime contractor had breached the prime contract. This subsection has been deleted as unnecessary and repetitive.

SECTION 7: ADMINISTRATIVE OFFSETS

The existing Act provides that the amount of any kickback "shall be recoverable on behalf of the United States from the subcontractor or the recipient thereof by setoff of moneys otherwise owing to the subcontractor either directly by the United States, or by a prime contractor under any contract. . . ." 41 U.S.C. 51. Section 7 of S. 2250 preserves this right of offset, with some modifications and extensions.

Section 7(a) provides general authorization for the United States to recover the amount of a kickback through an administrative offset. However, the section authorizes such offsets only where a kickback has actually been paid, accepted or charged in violation of the Act. Thus, it does not authorize offsets in cases of attempted misconduct. The section permits the United States to offset a kickback amount from any debt it owes to persons who paid or received a kickback or who included kickback costs in a contract price. Thus, the section is not restricted to offsets involving subcontractors or kickback recipients.

Section 7(b) retains the United States' right to exercize an offset through a prime contractor and further permits the prime contractor, in cases the Government deems appropriate, to recoup the offset sums from a subcontractor. The subsections implementing these provisions work in tandem and should be read together.

For example, read together, subsections 7(b)(1) and 7(b)(2)(A) apply to cases in which the United States wishes to recover kickback costs from a subcontractor but does not owe the subcontractor sufficient sums to institute a direct offset under Section 7(a). In this event, the Government may direct the prime contractor, under subsection 7(b)(1), to withhold the necessary sums from monies that the prime contractor owes the subcontractor and, under subsection 7(b)(2)(A), to pay those sums to the appropriate Government agency. In this way, the United States recovers its kickback costs administratively from the subcontractor, by acting through the prime contractor.

Subsections 7(b)(1) and 7(b)(2)(B), read together, apply to cases in which the United States has already executed an offset against a prime contractor but wishes to authorize the prime contractor to recoup the offset sums from an appropriate subcontractor. In this

event, on instruction of the Government, subsection 7(b)(1) permits the prime contractor to withhold from sums it owes the subcontractor the amount of any kickback paid, accepted or charged in violation of the Act. Again on instruction from the Government, subsection 7(b)(2)(B) permits the prime contractor to keep this money (rather than pay it to the United States) since the United States has already collected that sum from the prime contractor through an administrative offset. The subsection requires the prime contractor to notify the contracting officer when, after being instructed to do so, it, in fact, has retained money under the authority of subsection 7(b)(2)(B).

Section 7(b) was designed primarily to benefit those prime contractors who are unwitting participants in subcontractor kickback schemes, by enabling them to recoup from appropriate subcontractors any kickback costs which the United States recovered from the prime contractors through administrative offsets. The provisions are, of course, in addition to other legal remedies which a prime contractor may pursue to recoup such losses from an appropriate party.

As a safeguard, a prime contractor may not invoke Section 7(b) unilaterally; it must convince a contracting officer to allow the prime contractor to proceed under the section. By assigning the responsibility of initiating the offset procedures to the contracting officer, the bill seeks to assure that due regard will be paid to the purposes of the Act and the facts of each case. For example, it is not intended that a contracting officer will authorize a prime contractor to retain funds under subsection 7(b)(2)(B) in cases where the prime contractor was a knowing participant in a kickback scheme perpetrated by the subcontractor or in cases where the identity of the subcontractor responsible for paying the kickback is unclear. Moreover, the contracting officer's participation links the acts taken under Section 7(b) to the protections afforded by the Contract Disputes Act of 1978, governing interactions between contracting officers and prime contractors. Thus, if a prime contractor disagrees with, for example, a contracting officer's instruction to withhold funds from a particular subcontractor, it has recourse to review procedures set forth in the Contract Disputes Act.

SECTION 8: CONTRACTOR REQUIREMENTS

Section 8 of S. 2250 imposes new responsibilities on prime contractors and subcontractors. These provisions are intended to increase contractor participation in efforts to deter subcontractor kickbacks.

Section 8(a) states that all Government contracts must require prime contractors to "have in place and follow reasonable procedures designed to prevent and detect violations" of the Act. This provision is intended to encourage prime contractors to institute formal procedures to combat subcontractor kickbacks.

These procedures may include, but are not limited to, company ethics rules prohibiting kickbacks by employees, agents or subcontractors; education programs for new employees and subcontractors, explaining policies against kickbacks, related company procedures and the consequences of detection; procedures requiring sub-

contractors to declare that they have not paid kickbacks to obtain favorable treatment in the procurement process; specified subcontract penalties if kickbacks are discovered; procurement procedures to minimize kickback activities such as limits on buyers' authority to approve bids, controlled receipt of bid packages and other measures; audit procedures designed to detect kickbacks such as reviews of employee expense reports, reivews of the documentation supporting subcontract awards and other measures; periodic surveys of subcontractors to elicit information about kickbacks; information "hotlines" to handle anonymous tips; and procedures to report possible kickback activities to law enforcement officials.

Two types of procedures merit special attention. First, some defense prime contractors already require their employees to submit annual, written declarations that the employee has read and will abide by the company's ethics rules. The Committee supports such declarations as a way of alerting employees to their ethical responsibilities. Prime contractors may wish to expand these forms to require: (a) annual certifications that the employee has not violated and is unaware of any other person or company violating the ethical rules during the prior year; or (b) annual declarations of gifts or gratuities exceeding a specified dollar amount which the employee received, directly or indirectly, from a subcontractor during the prior year. As introduced, S. 2250 included a provision similar to (b). The section was deleted from the final bill, to permit prime contractors to test the usefulness of it and other self-policing measures.

Second, the June hearing before the Senate Oversight Subcommittee established that poor personnel practices in the defense industry are contributing to the problem of subcontractor kickbacks by permitting corrupt prime contractor employees to obtain reemployment in the field. In assessing the reasonableness of prime contractors' procedures to prevent kickbacks, contracting agencies should review the contractors' personnel practices to insure that they are designed to provide for the exchange of accurate and relevant information about prospective, current and former employees.

Acceptable personnel practices should include, for example, procedures to obtain important information about job applicants prior to making hiring decisions, including the circumstances under which the applicant left or wants to leave a former or current job, whether the applicant is suspected of unethical conduct by a former or current employer, and whether the applicant would be eligible for re-hire by a former employer; procedures to record accurate information in an employee's personnel file, including information gathered during the job application process, whether the employee is or has been suspected of unethical conduct, whether there are key files on the employee in other parts of the company and, if appropriate, the circumstances surrounding the employee's departure from the company and eligibility for re-hire; procedures to coordinate personnel files and other company files evaluating whether an employee has engaged in unethical conduct; standards for terminating employees believed responsible for unethical conduct; procedures to update personnel files with arrest and conviction information related to unethical business practices; and, most important, in response to inquiries by prospective employers, proce-

dures to provide accurate and relevant information about current or former emplyees regarding unethical conduct.

The Committee recognizes that prime contractors will not be able to implement "fool-proof" procedures to discover or eliminate subcontractor kickbacks. Section 8(a) does not require such procedures. Instead, the section requires procedures which are reasonably related to the goal of preventing and detecting kickbacks and which are adhered to with reasonable diligence by the prime contractor. In this way, the bill seeks to encourage prime contractors to institute thoughtful, self-policing measures to stop subcontractor kickbacks.

Section 8(b) states that all Government contracts must require prime contractors to cooperate fully with any federal kickback investigation. This provision institutes a legal incentive, enforceable with contract remedies, to cooperate with law enforcement and procurement officials investigating possible kickbacks. Full cooperation includes, but is not limited to, promptly reporting possible kickbacks to federal officials as provided in Section 8(c) and providing access to relevant company documents including reports on possible kickback activities.

Section 8(c) requires prime contractors and subcontractors, when they have "reasonable grounds to believe" kickback activities "may have occur," to report their suspicions, in writing, to one of the federal officials listed in subsection 8(c)(1)(B).

This section originally applied only to "prime contractors," requiring them to report "possible violations" of the Act. On the recommendation of the Department of Justice and industry representatives, it was amended to apply also to subcontractors. This change means higher tier subcontractors have to report kickback offers by lower tier subcontractors as well as kickback solicitations by prime contractor employees. The section was further amended to require reports only when a contractor has "reasonable grounds to believe" a violation of the Act may have occurred. This change was intended to make it clear that contractors do not have to report mere rumors of kickback activities. On the other hand, contractors do not have to be certain of wrongdoing before alerting authorities. Instead, contractors are required to report kickback suspicions which they have reason to believe may be true.

This provision was instituted to overcome the reluctance of contractors to report possible kickback activities. Testimony before the Subcommitte indicated that prime contractors may now refrain from reporting such suspicions, due to our legal system's presumption that individuals are innocent until proven guilty, the possibility of civil suits for defamation, and fears of adverse publicity. By legally requiring reports of potential kickback activities, Section 8(c) is intended to make it clear that a contractor has a responsibility to report suspicious conduct.

Some industry representatives requested the Subcommittee to include in the bill a provision requiring the United States to indemnify contractors for any civil damage awards which may result from their making the reports required by Section 8(c). The Committee did not follow this suggestion for several reasons.

First, the Committee believes that contractors are not now civilly liable for reporting legitimate suspicions of wrongdoing to law en-

forcement officials. Second, with the passage of Section 8(c), the Committee does not anticipate that courts will penalize contractors for complying with legal obligations to report misconduct, particularly if their reports are factual and communicate the basis for their suspicions. Further, in cases where a contractor knowingly submits erroneous information to federal officials, the United States should not be held liable for the contractor's actions.

Section 8(c)(2) was added to the bill to address contractor concerns that reporting potential violations of the Act would subject them to suspension or debarment proceedings based upon the underlying misconduct. This section provides that reporting potential violations of the Act must be viewed as favorable evidence of a contractor's present responsibility to contract with the federal Government. Thus, while reporting violations would not be conclusive proof of a contractor's present responsibility and would not immunize the contractor from suspension or debarment proceedings, it is to be viewed as helpful evidence.

SECTION 9: INSPECTION AUTHORITY

The existing Act enables the GAO to inspect the facilities and to audit the books and records of "any prime contractor or subcontractor engaged in the performance of a negotiated contract" in order to ascertain whether kickbacks have taken place. 41 U.S.C 53. Section 9 of S. 2250 preserves this right of inspection and audit, expanding it in two ways.

First, in accordance with the bill's goal of making the Act applicable to all types of prime contracts, Section 9 removes any reference to a "negotiated contract." Second, Section 9 extends GAO's right of inspection and audit to the inspector generals of contracting agencies and, for contracting agencies without inspector generals, to representatives designated by the agency heads. Federal agencies did not have inspector generals when the Anti-Kickback Act was enacted in 1946 or when it was amended in 1960. Section 9 recognizes that they are currently the Government's foremost investigators of federal program fraud and should have access to the same investigative tools available to the GAO.

MISCELLANEOUS PROVISIONS

In other provisions, S. 2250 simplifies the descriptive title of the Act. It also states that the bill will apply to prohibited conduct "which occurs on or after the date" of the bill's enactment. Finally, it states that Section 8 of the bill will apply to contract solicitations issued 90 days after the bill's enactment. This 90-day period will allow federal agencies time to develop contract language and any regulations necessary to implement that section's provisions.

IV. CONCLUSION

The Anti-Kickback Act has not been amended in 25 years. It is the only statute in the United States Code which focuses on the problem of subcontractor kickbacks. By stiffening criminal penalties, expanding the civil recovery provisions, prohibiting kickbacks on any type of prime contract to obtain any type of favorable treat-

ment, and otherwise modernizing and broadening the Act, the bill is a bipartisan effort to strengthen the legal deterrence to subcontractor fraud. The Committee strongly supports the bill's enactment into law.

V. Section-by-Section Analysis

SECTION 1

The short title of the bill is the Anti-Kickback Enforcement Act of 1986.

SECTION 2

This section amends Title 41 of the United States Code by clarifying and strengthening the Anti-Kickback Act of 1946, Sections 51–54 of that Title. The section's provisions would replace the provisions of the existing Act. (The following section numbers refer to the sections of the Anti-Kickback Act of 1986, should S. 2250 be enacted into law.)

Section 1 sets forth the title of the Act. Section 2 defines key terms in the Act. Section 3 describes the conduct prohibited by the Act and also preserves the conclusive presumption in the existing Act. Section 4 contains the criminal provisions in the Act. Section 5 contains the provisions in the Act for civil recovery of kickback costs, authorizing, *inter alia*, double damages and forfeitures in cases of knowing misconduct. Section 6 codifies *United States* v. *Acme Process Equipment Co.*, 385 U.S. 138 (1966), which authorizes the United States to terminate prime contracts tainted by subcontractor kickbacks. Section 7 describes the United States' right to exercise administrative offsets to recover kickback costs. Section 8 instructs contracting agencies to include language in their prime contracts which requires prime contractors to implement and follow reasonable procedures designed to detect and prevent kickbacks and to cooperate fully with kickback investigations. Section 8 also requires contractors to report possible kickback activities to appropriate federal officials. Section 9 maintains the General Accounting Office's right to inspect and audit books, records and facilities to discover subcontractor kickbacks and extends that right to other federal agencies.

SECTION 3

Section 3 sets the effective date of the legislation.

VI. Estimated Cost of Legislation

U.S. Congress,
Congressional Budget Office,
Washington, DC, August 21, 1986.

Hon. William V. Roth, Jr.,
Chairman, Committee on Governmental Affairs, U.S. Senate, Dirksen Senate Office Building, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office has reviewed S. 2250, the Anti-Kickback Enforcement Act of 1986, as ordered reported by the Senate Committee on Governmental Affairs

on August 12, 1986. We estimate that enactment of this bill would result in no significant cost to the federal government, or to state or local governments. Furthermore, the bill could create significant savings over time by reducing contract fraud, and thus the cost of federal procurements.

The most common types of kickbacks are payments from subcontractors to purchasing agents (buyers) employed by prime contractors. Kickbacks can be awarded for any number of reasons, often to secure the awarding of a contract, but also to mask substandard work, overcharges, and inferior merchandise. The amount of the kickback generally is hidden in the contract price, and based on congressional testimony, can raise contract prices by an estimated 2 to 15 percent. For example, based on testimony provided by the Office of the U.S. Attorney, kickbacks may have cost the Department of Defense between $250 million and $10 billion in fiscal year 1985.

Sections 2, 3, and 4 of S. 2250 would broaden the applicability and strength the criminal provisions involving kick-backs in negotiated contracts, as well as sealed bids and other non-negotiated contracts. It would increase the penalty for receiving a kick-back from 2 to 10 years imprisonment, and the maximum fine from $10,000 to $250,000. The panalty would apply to anyone who knowingly engaged in prohibited conduct, not just those who offered or received kickbacks. Any increase in the Department of Justice (DOJ) administrative expenses is difficult to predict, however, because the number of kickback-related cases currently prosecuted is not available, and the number and complexity of future cases is uncertain. It is likely that these costs would be more than offset by reduced contract costs and revenue from penalties, however. Thus, enactment of these provisions would probably result in no significant cost to the federal government, and could result in a significant savings to the extent that these changes would reduce the cost of federal procurements.

Section 5 of the bill would allow the government to recover damages incurred because of kickbacks. It would permit civil recovery from anyone who violates the act, not just subcontractors, and would allow for the collection of double damages by the government. Because the federal government would be able to sue for damages in all such cases, it is expected that enactment of these changes could increase revenues to the government, but we can not estimate precisely this additional savings.

Sections 6 and 7 would amend the government's contracting procedures, allowing the government to terminate prime contracts that have been associated with subcontract kickbacks, and to recover kickbacks by offsetting these amounts against funds owed by the federal government. Agencies could write new regulations to enforce these provisions. Any additional administrative or regulatory expenses incurred by the agencies, however, would probably be less than increases from income received from administrative offsets.

Section 8 would impose new restrictions on prime contractors and subcontractors, requiring all contractors to develop and follow reasonable procedures designed to prevent and detect kickback violations. This requirement is expected to result in an overall reduction in kickbacks and a subsequent reduction in contract prices, ac-

cording to the DOJ, but we are unable at this time to estimate the precise amount of this savings.

Section 9 would clarify and codify the right of an agency's inspector general's office to investigate contractors for kickback violations. These offices should not need increased resources because the act only clarifies their current authority.

If you wish further details on this estimate, we will be pleased to provide them.

With best wishes,

Sincerely,

EDWARD GRAMLICH
(For Rudolph G. Penner, Director).

VII. EVALUATION OF REGULATORY IMPACT

Pursuant to the requirements of paragraph 11(b) of Rule XXVI of the Standing Rules of the Senate, the Committee has considered the regulatory and paperwork impact of S. 2250, as well as the impact of the bill on personnel privacy.

The regulatory impact of S. 2250 should be minimal. The Federal Acquisition Regulation (FAR) will have to be amended to incorporate the new contract language required by Section 8 of the bill, but the needed provisions should be easily formulated and may closely parallel the language already in the bill. The bill does not mandate other regulations, although agencies may wish to institute implementing regulations for sections 6 (contract terminations), 7 (administrative offsets) or 8 (contractor requirements). Any such regulations would apply to persons and businesses who enter into contracts with the United States. The economic impact of these regulations should be minimal.

The necessary amendment to the FAR and the possible implementing regulations under this bill are not expected to have a significant impact on the personal privacy of the individuals affected. For example, reporting possible illegal activity and exchanging information about prospective employees are already protected under common law and they do not create new inroads into personal privacy.

These regulations are also expected to have a minimal impact on paperwork requirements. The notices and reports required in sections 6, 7 and 8 generally come into play only in cases of subcontractor kickbacks, they are not expected to be lengthy or complex, and they should not unduly burden individuals or companies doing business with the United States.

VIII. COMMITTEE VOTE

In compliance with paragraph 7(c) of Rule XXVI of the Standing Rules of the Senate, the vote of the Committee on this legislation was as follows:

Final passage: Ordered reported, 10 yeas; 0 nays.

YEAS	NAYS
Roth	
Stevens	
Mathias	

Cohen
Durenberger
Cochran
Eagleton
Nunn
Levin
Gore

IX. Changes in Existing Law

In compliance with paragraph 12 of Rule XXVI of the Standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic):

TITLE 41—PUBLIC CONTRACTS

* * * * * *

CHAPTER 1—GENERAL PROVISIONS

* * * * * *

[§ 51. Fees or kick-backs by subcontractors on negotiated contracts; recovery by United States; conclusive presumptions; withholding of payments

[The payment of any fee, commission, or compensation of any kind or the granting of any gift or gratuity of any kind, either directly or indirectly, by or on behalf of a subcontractor, as defined in section 52 of this title, (1) to any officer, partner, employee, or agent of a prime contractor holding a negotiated contract entered into by any department, agency, or establishment of the United States for the furnishing of supplies, materials, equipment or services of any kind whatsoever; or to any such prime contractor or (2) to any officer, partner, employee, or agent of a higher tier subcontractor holding a subcontract under the prime contract, or to any such subcontractor either as an inducement for the award of a subcontract or order from the prime contractor or any subcontractor, or as an acknowledgment of a subcontract or order previously awarded, is prohibited. The amount of any such fee, commission, or compensation or the cost or expense of any such gratuity or gift, whether heretofore or hereafter paid or incurred by the subcontractor, shall not be charged, either directly or indirectly, as a part of the contract price charged by the subcontractor to the prime contractor or higher tier subcontractor. The amount of any such fee, cost, or expense shall be recoverable on behalf of the United States from the subcontractor or the recipient thereof by setoff of moneys otherwise owing to the subcontractor either directly by the United States, or by a prime contractor under any contract or by an action in an appropriate court of the United States. Upon a showing that a subcontractor paid fees, commissions, or compensation or granted gifts or gratuities to an officer, partner, employee, or agent of a prime contractor or of another higher tier subcontractor, in connection with the award of a subcontract or order thereunder, it shall be conclusively presumed that the cost of such ex-

pense was included in the price of the subcontract or order and ultimately borne by the United States. Upon the direction of the contracting department or agency or of the General Accounting Office, the prime contractor shall withhold from sums otherwise due a subcontractor any amount reported to have been found to have been paid by a subcontractor as a fee, commission, or compensation or as a gift or gratuity to an officer, partner, employee, or agent of the prime contractor or another higher tier subcontractor. Mar. 8, 1946, c. 80, § 1, 60 Stat. 37; Sept. 2, 1960, Pub. L. 86-695, 74 Stat 740.

[§ 52. Same: definitions

[For the purpose of sections 51-54 of this title, the term "subcontractor" is defined as any person, including a corporation, partner- ship, or business association of any kind, who holds an agreement or purchase order to preform all or any part of the work or to make or to furnish any article or service required for the performance of a negotiated contract or of a subcontract entered into thereunder; the term "person" shall include any subcontractor, corporation, association, trust, joint-stock company, partnership, or individual; and the term "negotiated contract" means made without formal advertising. Mar. 8, 1946, c. 80, § 2, 60 Stat. 38; Sept. 2, 1960, Pub. L. 86-695, 74 Stat. 740.

[§ 53. Same: power of General Accounting Office

[For the purpose of ascertaining whether such fees, commissions, compensation, gifts, or gratuities have been paid or granted by a subcontractor, the General Accounting Office shall have the power to inspect the plants and to audit the books and records of any prime contractor or subcontractor engaged in the performance of a negotiated contract. Mar. 8, 1946, c. 80, § 3, 60 Stat. 38; Sept. 2, 1960, Pub. L. 86-695, 74 Stat. 741.

[§ 54. Same: penalties

[Any person who shall knowingly, directly or indirectly, make or receive any such prohibited payment shall be fined not more than $10,000 or be imprisoned for not more than two years, or both. Mar. 8, 1946, c. 80, § 4, 60 Stat. 38; Sept 2, 1960, Pub. L. 86-695, 74 Stat. 741.]

"SHORT TITLE

"SECTION 1. This Act may be cited as the 'Anti-Kickback Act of 1986'.

"DEFINITIONS

"SEC. 2. As used in this Act:

"(1) 'Contracting agency', when used with respect to a prime contractor, means any department, agency, or establishment of the United States which enters into a prime contract with a prime contractor.

"(2) 'Kickback' means any money, fee, commission, credit, gift, gratuity, thing of value, or compensation of any kind which is provied, directly or indirectly, to any prime contractor, prime

contractor employee, subcontractor, or subcontractor employee for the purpose of obtaining or acknowledging favorable treatment in connection with a prime contract or in connection with a subcontract relating to a prime contract.

"(4) 'Prime contract' means a contract or contractual action entered into by the United States for the purpose of obtaining supplies, materials, equipment, or services of any kind.

"(5) 'Prime contractor' means a person who has entered into a prime contract with the United States.

"(6) 'Prime contractor employee' means any officer, partner, employee, or agent of a prime contractor.

"(7) 'Subcontract' means a contract or contractual action entered into by a prime contractor or subcontractor for the purpose of obtaining supplies, materials, equipment, or services of any kind under a prime contract.

"(8) 'Subcontractor'—

"(A) means any person, other than the prime contractor, who offers to furnish or furnishes any supplies, materials, equipment, or services of any kind under a prime contract or a subcontract entered into in connection with such prime contract; and

"(B) includes any person who offers to furnish or furnishes general supplies to the prime contractor or a higher tier subcontractor.

"(9) 'Subcontractor employee' means any officer, partner, employee, or agent of a subcontractor.

"PROHIBITED CONDUCT; PRESUMPTION THAT PROHIBITED CONDUCT OCCURRED

"SEC. 3. (a) It is prohibited for any person—

"(1) to pay, attempt to pay, or offer to pay any kickback;

"(2) to solicit, accept, or attempt to accept any kickback; or

"(3) to include, directly or indirectly, the amount of any kickback prohibited by clause (1) or (2) in the contract price charged by a subcontractor to a prime contractor or a higher tier subcontractor or in the contract price charged by a prime contractor to the United States.

"(b) In a civil suit or administrative action commenced under this Act, there shall be a conclusive presumption that the amount of any kickback paid or accepted in connection with a prime contract or subcontract inviolation of subsection (a)(1) or (a)(2) has been included in the price of such contract and has been ultimately borne by the United States.

"CRIMINAL PENALTIES

"SEC. 4. (a) Any individual who knowingly engages in conduct prohibited by section 3(a) shall be fined not more than $250,000 or be imprisoned for not more than 10 years or both.

"(b) Any person (other than an individual) who knowingly engages in conduct prohibited by section 3(a) shall be fined not more than $1,000,000.

"CIVIL ACTIONS

"SEC. 5. (a)(1) The United States may bring a civil suit against any person who violates section 3(a).

"(2) In a civil suit brought under paragraph (1), the United States may recover—

"(A) in the case of a person who knowingly engages in conduct prohibited by section 3(a), an amount equal to the sum of—

"(i) twice the amount of each kickback involved in the violation; and

"(ii) not more than $10,000 for each occurrence of prohibited conduct; or

"(B) in any other case, the amount of each kickback involved in the violation.

"(b) A civil action under this section shall be barred unless the action is commenced within 6 years after the later of (1) the date on which the prohibited conduct establishing the cause of action occurred, and (2) the date on which the United States should reasonably have become aware that the prohibited conduct had occurred.

"TERMINATION OF CONTRACTS

"SEC. 6. If a violation of section 3(a) has occurred in connection with a prime contract, as determined by the head of the contracting agency, the head of such agency may, by written notice to the prime contractor, terminate the prime contract for default. Any such termination shall be governed by the Contract Disputes Act of 1978.

"ADMINISTRATIVE OFFSETS

"SEC. 7. (a) The United States may recover the amount of any kickback paid, accepted, or charged in violation of section 3(a) by offsetting such amount against any moneys owed by the United States—

"(1) to the prime contractor, prime contractor employee, subcontractor, or subcontractor employee which included such amount in a contract price; or

"(2) to the recipient or recipients of such kickback.

"(b)(1) Upon the written direction of the contracting officer for a prime contract, the prime contractor shall withhold from sums the prime contractor owes any subcontractor the amount of any kickback found to have been paid, accepted, or charged in violation of section 3(a).

"(2) Upon the written direction of the contracting officer for a prime contract, the prime contractor (A) shall pay all sums withheld under paragraph (1) to the contracting agency, or (B) shall retain such sums, if the United States has, by administrative offset under subsection (a), collected such sums from the prime contractor, and shall notify the contracting officer of the retention and the reasons for the retention.

"CONTRACTOR RESPONSIBILITIES

"SEC. 8. (a) Each contracting agency shall include in each prime contract awarded by such agency a requirement that the prime con-

tractor shall have in place and follow reasonable procedures designed to prevent and detect violations of section 3(a).

"(b) Each contracting agency shall include in each prime contract awarded by such agency a requirement that the prime contractor shall cooperate fully with any Federal Government agency investigating a violation of section 3(a).

"(c)(1)(A) Whenever a prime contractor or subcontractor has reasonable grounds to believe that a violation of section 3(a) may have occurred, the prime contractor or subcontractor shall promptly report the potential violation in writing.

"(B) A contractor shall make the reports required by subparagraph (A) to the inspector general of the contracting agency, the head of the contracting agency if the agency does not have an inspector general, or the Department of Justice.

"(2) In the case of an administrative or contractual action to suspend or debar any person who is eligible to enter into contracts with the Federal Government, evidence that such person has supplied information to the United States pursuant to paragraph (1) shall be favorable evidence of such person's responsibility for the purposes of Federal procurement laws and regulations.

"INSPECTION AUTHORITY

"SEC. 9. For the purpose of ascertaining whether there has been a violation of section 3(a) with respect to any prime contract, the General Accounting Office and the inspector general of the contracting agency, or a representative of such contracting agency designated by the head of such agency if the agency does not have an inspector general, may inspect the facilities and audit the books and records of any prime contractor or subcontractor under a prime contract awarded by such agency.".

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